

Internal Revenue Service

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Department of the Treasury

Washington, DC 20224

Third Party Communication: None

Date of Communication: Not Applicable

Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

CC:PSI:B02

PLR-112943-08

Date:

September 09, 2008

X =

State =

A =

B =

C =

E =

D1 =

D2 =

D3 =

D4 =

D5 =

D6 =

Dear

This responds to a letter dated March 14, 2008, and subsequent correspondence submitted on behalf of X by X's authorized representative, requesting a ruling under § 1362(g) of the Internal Revenue Code.

FACTS

The information submitted states that X was incorporated under the laws of State on D1 and elected to be an S corporation effective D2. On D3, X terminated its S election by recapitalizing its common stock (A% ownership interest in X) into common stock (B% ownership interest in X) and employee stock option plan (ESOP) convertible preferred stock (C% ownership interest in X). On D4, the four X shareholders sold the ESOP convertible stock (C% ownership interest in X) to X's ESOP and two shareholders elected § 1042 treatment on the sale of their stock. Section 1042 treatment was elected for the sale of approximately E% of the total ownership interests in Taxpayer. On D5, X redeemed all of its common stock causing the X ESOP to become the sole X shareholder.

X requests permission under § 1362(g) to reelect S corporation status effective D6, a date that is prior to the termination of the five year waiting period required by the Code. X is not requesting a ruling on the validity of the shareholder's § 1042 election.

LAW AND ANALYSIS

Section 1362(a) provides that except as provided in § 1362(g), a small business corporation may elect to be an S corporation.

Section 1361(b)(1) provides, in part, that for the purposes of subchapter S, the term "small business corporation" means a domestic corporation which is not an ineligible corporation and which does not (B) have as a shareholder a person (other than an estate, trust described in § 1361(c)(2), or an organization described in § 1361(c)(6)) who is not an individual and (D) have more than one class of stock.

Section 1361(c)(6) provides that for purposes of § 1361(b)(1)(B), an organization which is described in §§ 401(a) or 501(c)(3), and exempt from taxation under § 501(a) may be a shareholder in an S corporation. ESOPs as defined in § 4975(e)(7) are described in § 401(a) and exempt from taxation under § 501(a).

Section 1362(d)(2)(A) provides that an election under § 1362(a) shall be terminated whenever (at any time on or after the 1st day of the 1st taxable year for which the corporation is an S corporation) such corporation ceases to be a small business corporation.

Section 1042(a) provides that if the taxpayer elects the application of § 1042(a) with respect to any sale of qualified securities, the taxpayer purchases qualified replacement

property within the replacement period, and the qualified securities are sold to an ESOP holding 30% of the stock after the sale, then the gain (if any) on such sale which would be recognized as long-term capital gain shall be recognized only to the extent that the amount realized on such sale exceeds the cost to the taxpayer of such qualified replacement property. Qualified securities under § 1042(c)(1) must be employer securities issued by a domestic C corporation.

Section 1362(g) provides that if a small business corporation has made an S corporation election under § 1362(a), and if such election has been terminated under § 1362(d), the corporation (and any successor corporation) is not eligible to make another election under § 1362(a) for any taxable year before its fifth taxable year which begins after its first taxable year for which the termination is effective, unless the Secretary consents to the election.

Section 1.1362-5(a) provides that the fact that more than 50% of the stock in the corporation is owned by persons who did not own any stock in the corporation on the date of the termination tends to establish that consent should be granted. In the absence of this fact, consent ordinarily is denied unless the corporation shows that the event causing termination was not reasonably within the control of the corporation of shareholders having a substantial interest in the corporation and was not part of a plan on the part of the corporation or of such shareholders to terminate the election.

We deny X's request to reelect S corporation status under § 1362(g) before the expiration of the five year statutory waiting period. While an ESOP may be an S corporation shareholder under § 1361(b)(1)(B), only C corporation shareholders may sell their stock to an ESOP and defer the gain by electing § 1042 treatment for a qualified stock sale. X terminated its S corporation status on D3 under § 1362(d)(2)(A) when X recapitalized creating two classes of stock. The election of § 1042 treatment by two shareholders with respect to their sale of X stock to the ESOP on D4 precluded § 1362(g) relief without regard to the D5 redemption of X stock causing a more than 50% ownership change as described in § 1.1362-5(a).

Except as specifically set forth above, no opinion is expressed concerning the federal tax consequences of the facts described above under any other provision of the Code. Specifically, no opinion is expressed regarding whether X was or is eligible to be an S corporation without regard to the transactions discussed, or concerning the selling shareholders' § 1042 elections.

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

Pursuant to a power of attorney on file with this office, a copy of this letter is being sent to X's authorized representative.

Sincerely,

Bradford R. Poston
Senior Counsel, Branch 2
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosures (2)
Copy of this letter
Copy for § 6110 purposes

cc: